Senate Bill 803 (Governance and Finance Committee)
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Date: 03/24/15
Program: Property Tax
Sponsor: Board of Equalization (Suggestions 1-1 – 1-5)
Government Code Section 7510
Revenue and Taxation Code Sections 63.1, 68, 401.10, and 423.2
Effective: January 1, 2016

This analysis is limited to the bill's effect on the BOE-related tax programs

Summary: Among other things, contains Board of Equalization (BOE)-sponsored housekeeping and technical Property Tax proposals to:

- Replace a valuation methodology related to possessory interests in state retirement system-owned property which was ruled unconstitutional. *(Government Code Section 7510)*
- Expressly provide that the parent-child change in ownership exclusion applies to a transfer of a pro rata ownership interest in a resident-owned manufactured home park or a floating home marina owned by a legal entity. *(Revenue and Taxation Code (RTC) Section 63.1)*
- Allow displaced persons to prospectively receive an eminent domain base year value transfer on late-filed claims. *(RTC Section 68)*
- Extend for five years the assessment valuation methodology for intercounty pipeline rights-of-way, which are otherwise scheduled to sunset. *(RTC Section 401.10)*
- Correct the subdivision references to Government Code Section 16142, related to Williamson Act assessments. *(RTC Section 423.2)*

Fiscal Impact Summary: No impact.

Possessory Interests – PERS and STRS
Government Code Section 7510

Purpose: To replace a possessory interest valuation methodology for state retirement system-owned property, which a court ruled unconstitutional.

Existing Law: Government Code Section 7510 contains provisions specific to possessory interests in state retirement system-owned property (i.e., investment real property owned by the Public Employees Retirement System (PERS) and the State Teachers Retirement System (STRS)). This law specifies a valuation methodology for the assessor to value a lessee's possessory interest in PERS- and STRS-owned property.

The law[1] provides that, where a lessee has leased the entire property, the assessed value is limited to the full cash value of the taxable possessory interest. If, however, the lessee has leased less than the entire property, the assessed value of each taxable possessory interest is the greater of (1) the full cash value of the taxable possessory interest or (2) a value based on the possessor's allocable share of the full cash value of the real property, which is the value that would have been enrolled under Article XIII A of the California Constitution and related statutes for the entire fee simple interest. The law further provides that each possessor's "allocable share" shall be a simple allocation based on the square feet leased by the possessor divided by the total leasable square feet of the real property.[2]

[1] Subdivision (b)(1) of Government Code Section 7510.
[2] Assessors' Handbook Section 510, *Assessment of Taxable Possessory Interests*, page 73.

Proposed Law: This bill deletes the above formula and replaces it with a reference to a pre-existing BOE regulation.[3] This regulation applies to the valuation of taxable possessory interests generally.

In General: In certain instances, a property tax assessment may be levied when a person or entity uses publicly-owned real property that, with respect to its public owner, is either immune or exempt from property taxation.[4] These uses are commonly referred to as "possessory interests" and are typically found where an individual or entity leases, rents, or uses federal, state or local government facilities and/or land.

Background: On May 7, 2013, the Second District Court of Appeal (*California State Teachers' Retirement System v. County of Los Angeles,* (2013) 216 Cal.App.4th 41[5] held that the valuation methodology provided in Section 7510(b)(1) is unconstitutional. First, the court noted that Section 7510(b)(1) does not become constitutional simply because it shifts the tax on the reversionary interest to the lessees. The court concluded that the value of rights retained by the exempt owner of the real property (reversionary interest) must be excluded in order to determine the proper value of the lessee's taxable possessory interest. Second, by including the full value of the fee interest in the assessable value of the lessee's possessory interest, Section 7510(b)(1) also violates the prohibition on taxing property in excess of its fair market value. Including the value of the retirement system's reversionary interest in the value of the lessee's possessory interest increased the assessed value of the possessory interest above its fair market value. The court opined that the correct possessory interest valuation standard is fair market value, rather than the formula dictated by Section 7510(b)(1).

The court directed that the matter be remanded back to the assessment appeals board to determine the proper value of the possessory interest pursuant to the valuation method contained in the BOE's regulation Property Tax Rule 21, "Taxable Possessory Interests – Valuation."

At the request of the court, the BOE filed an *amicus curiae* brief with the court. After the decision, the BOE issued guidance to assessors via Letters to Assessors 2014/023.

Commentary:

1. **Court rules the law is unconstitutional.** This bill amends Government Code Section 7510 to conform to the 2013 court ruling. The court ruled the method unconstitutional because in some cases it taxes the lessee based on the entire fee simple interest.[6] This method is improper because the lessee is assessed for both the possessory and reversionary interest even though the lessee only owns a possessory leasehold interest.

2. **Assessors would use Property Tax Rule 21 to value the possessory interest.** Property Tax Rule 21, which is applicable to possessory interests generally, is the proper valuation standard for investment property owned by state public retirement systems. This change will ensure that these possessory interests will not be valued in excess of fair market value.

[3] Property Tax Rule 21 "Taxable Possessory Interests – Valuation."
[4] Revenue and Taxation Code (RTC) Section 107.
[5] Letter to Assessors 2014/32.
[6] The entire fee simple interest includes the possessory interest plus the reversionary interest.

Parent-Child Exclusion: Mobile Homes and Floating Homes

Revenue and Taxation Code Section 63.1

Purpose: To expressly provide that the parent-child change in ownership exclusion applies to a transfer of a pro rata ownership interest in a resident-owned manufactured home park or a floating home marina owned by a legal entity.

Existing Law: Generally, the parent-child change in ownership exclusion does not apply to transfers of interests in legal entities.[7] However, the law provides three exceptions for certain resident-owned legal entities. These are:

- Cooperative housing corporations (i.e., co-ops)[8]
- Tenant-owned mobilehome parks[9]
- Tenant-owned floating home marinas[10]

Proposed Law: This bill includes a pro rata ownership interest in a legal entity that owns a mobilehome park and a floating home marina among the types of real property subject to the parent-child exclusion.

Background: The parent-child exclusion statute lists the cooperative housing corporation exception within its provisions. But the two other legal entity exceptions are not listed. Instead, they are addressed within other statutory provisions specific to mobilehome parks and floating home marinas. These provisions allow the resident-tenants to organize and buy their park or marina from the former owner without triggering any reassessment related to the initial conversion to resident ownership. But these laws provide that subsequent sales to new residents in the park or marina result in a pro rata reassessment of park or marina real property unless another exclusion,[11] like the parent-child exclusion, applies.

Commentary: Listing all the legal entity exceptions within the parent-child exclusion statute eliminates uncertainty for taxpayers and tax administrators and makes related code sections consistent.

Eminent Domain Base Year Value Transfer

Revenue and Taxation Code Section 68

Purpose: To allow displaced persons to prospectively receive an eminent domain base year value transfer on late-filed claims.

Existing Law: The law[12] allows owners of certain property taken by the government to acquire a replacement property without increased property tax liability through a "base year value transfer." The law requires the property owner to file a timely claim. To be timely, the property owner must file with the assessor a base year value transfer request within four years of the following dates, whichever is applicable:

- For property acquired by eminent domain—the date the final order of condemnation is recorded or the date the taxpayer vacates the property taken, whichever is later.

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[7] Parents and children must transfer real property, not an interest in a legal entity.
[8] RTC Section 63.1(c)(8).
[9] RTC Section 62.1(b)(1).
[10] RTC Section 62.5(b)(1).
[11] These exclusions include RTC Section 62 (Definitional Exclusions), Section 63 (Interspousal Transfers), and Section 63.1(Parent-Child Transfers).
[12] RTC Section 68.

- For property acquired by a public entity by purchase or exchange—the date of conveyance or the date the taxpayer vacates the property taken, whichever is later.
- For property taken by inverse condemnation—the date the judgment of inverse condemnation becomes final or the date the taxpayer vacates the property taken, whichever is later.

Proposed Law: This bill amends the law to allow prospective relief for base year value transfer claims filed after the four-year timeline, consistent with a recent court decision.

This bill also deletes obsolete date references and adds subdivision lettering for clarity.

In General: For property tax purposes, real property is reassessed from its Proposition 13 protected value (called a "base year value") to its current market value whenever a change in ownership occurs.[13] The law allows owners of certain property taken by the government to acquire a replacement property without increased property tax liability through a "base year value transfer." Specifically, the law does not define "change in ownership" to include the acquisition of real property as a replacement for comparable property[14] if the person acquiring the real property has been displaced by eminent domain proceedings, acquisition by a public entity, or governmental action resulting in a judgment of inverse condemnation. Instead of reassessing a newly acquired replacement property to its current value, the assessor "transfers" the base year value from the taken property to the replacement property, as specified.

To receive this constitutionally[15] provided property tax savings, the implementing statute[16] requires a person acquiring replacement property to request the base year value transfer within four years of the date the property was acquired by eminent domain or purchase or the date the judgment of inverse condemnation becomes final. A property tax rule[17] requires the taxpayer to acquire the replacement property before making the request and requires that the request be timely.[18]

Background: In 2014, a court ruled that a property owner should not be permanently barred from a base year value transfer because he or she makes a claim after the filing deadline. The Fourth District Court of Appeal, in Olive Lane Industrial Park, LLC *v*. County of San Diego (2014) Cal.App.4th 1480 held that RTC Section 68 does not expressly preclude prospective relief in the event a claim is filed after the four-year timeline, and Section 68 could be interpreted to permit prospective relief when a taxpayer acquires replacement property within the four-year period but misses the four-year filing deadline. The court held that "[t]his interpretation, which maintains the four-year deadline with respect to *acquisition* of the property but provides prospective relief for claims *filed* after the four-year period, accommodates the public policy interest in placing reasonable time limits on the exercise of constitutional rights, while also effectuating the plain language of Article XIIIA that a change in ownership does not occur when property is acquired to replace condemned property."

Both the parent-child change in ownership exclusion[19] and the base year value transfer provisions for persons over the age of 55 and the disabled[20] allow prospective relief for late-filed claims. The Legislature subsequently amended these laws so that taxpayers would not be permanently barred from these constitutionally authorized provisions.[21]

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[13] Cal. Const. Art. XIII A, Sec. 2
[14] Replacement real property is deemed comparable to the property taken if it is similar in size, utility, and function.
[15] Cal. Const. Art. XIII A, Sec. 2(d). Added by Proposition 3, June 1982.
[16] RTC Section 68.
[17] Property Tax Rule 462.500.
[18] It has long been the BOE's opinion that if a timely request is not made, the exclusion does not apply (Annotation 200.0315, C 12/22/1988).
[19] RTC Section 63.1(e)(2).
[20] RTC Section 69.5(f).
[21] Senate Bill 542 (Stats. 1997, Ch. 941) for RTC Section 63.1 and Assembly Bill 3076 (Stats. 2006, Ch. 364) for RTC Section 69.5.

Commentary:

1. **This bill permits prospective relief for base year value transfer claims filed after the four-year timeline.** This change is consistent with the court's decision. This amendment ensures that affected property owners will receive their constitutionally authorized right to property tax protection when their property is taken.
2. **Consistency with other laws.** Providing prospective relief is consistent with relief provided for other late-filed claims related to the parent-child change in ownership exclusion and base year value transfers for the elderly and disabled.

Valuation for Intercounty Pipelines

Revenue and Taxation Code Section 401.10

Purpose: To extend the intercounty pipeline rights-of-way valuation methodology that will otherwise sunset.

Existing Law: Existing law[22] sets forth the assessment methodology for assessors to value intercounty pipeline rights-of-way. The prescribed methodology applies to assessments made for the 1984-85 through 2015-16 tax years. The law sunsets on January 1, 2016.

Proposed Law: This bill extends the sunset on the codified valuation methodology for five years until January 1, 2021.

In General: The methodology for determining value applies a tiered dollars-per-mile schedule that is based on the property's density classification to establish the 1975-76 base-year value as follows:

- High Density: $20,000 per mile
- Transitional Density: $12,000 per mile
- Low Density: $9,000 per mile

These amounts are annually adjusted for inflation. The value derived by applying the statutory methodology is rebuttably presumed to be correct, precluding the property owner from challenging either the right-of-way value or the assessment's legality. The property owner may only challenge the assessment if the assessor declines to use the statutory methodology and, if so, the assessor loses the presumption of correctness.

Background: For a limited period between 1984 through 1993, the BOE asserted its assessment jurisdiction over both intercounty pipelines and intercounty pipeline rights-of-way. In 1993, a court ruled that, while BOE assessment jurisdiction over intercounty pipelines is proper, state assessment of the rights-of-way through which the pipelines run is not proper. Thus, the court directed county assessors to make these assessments. A key difference between state-assessed and locally-assessed property is that Proposition 13's acquisition-based value standard does not apply to state-assessed property. County-assessed property is assessed at the base year value (year of acquisition), increased by the annual 2% maximum inflation factor. (*Southern Pacific Pipe Lines, Inc*. v. *State Board of Equalization* (1993) 14 Cal.App.4th 42)

The initial transition from state to local assessment had several problems. First, the intercounty nature of the rights-of-way made the valuation process difficult under traditional local assessment procedures. Second, local assessments lacked statewide uniformity. Third, property owners contested the assessments' legality. Intercounty pipeline owners asserted that rights-of-way were not subject to assessment separate from the underlying fee parcel, and that the rights-of-way values were already reflected in the assessment of the fee parcel. Ultimately in 1996, to avoid costly and protracted

[22] RTC Section 401.10.

litigation, property owners and counties negotiated the settlement agreement that is currently in law. Both parties sought efficiency and cost-effectiveness in the local assessment of these interests to avoid administrative and economic waste. These provisions are scheduled to sunset after the 2015-16 fiscal year.

Previous Legislation. In 1996, AB 1286 (Takasugi, Stats. 1996, Ch. 801) codified the settlement agreement and established the valuation methodology.

- Sponsor: Los Angeles County and Western States Petroleum Association
- BOE position: Neutral

In 2000, AB 2612 (Brewer, Stats. 2000, Ch. 607), extended the methodology for 10 years.

- Author-sponsored
- BOE position: Support

In 2010, SB 1494 (Revenue and Taxation Committee, Stats. 2010, Ch. 654), extended the methodology for 5 years.

- BOE-sponsored, at the request of the California Assessors' Association and industry.

Commentary: For nearly 20 years, the valuation methodology has proven to work well. It is administratively cost-efficient and avoids assessment appeals and litigation.

Some assessors and taxpayer representatives have requested that these provisions be extended and the BOE sponsor legislation as part of its annual Property Tax Omnibus measures.

Williamson Act Assessments

Revenue and Taxation Code Section 423.3

Purpose: To correct cross references in the Government Code for prime agricultural land and other than prime agricultural land.

Existing Law: The cross references in the Revenue and Taxation Code to the Government Code for prime agricultural land and non-prime agricultural land definitions are incorrect.

Proposed Law: This bill updates cross references.

In General: The Williamson Act[23] helps conserve agricultural and open-space lands. Under the Williamson Act, landowners may enter into contracts with participating cities and counties to restrict the land to agricultural or open-space uses. The contract must be for a minimum 10-year term with automatic yearly extensions unless specific action to remove the property from the program is taken (i.e., nonrenewal or immediate cancellation). In exchange for entering into these contracts, the assessor values the land and any living improvements (trees and vines) according to income earning potential. The law provides a formula to value the land.[24] The valuation method capitalizes the income derived from the land's agricultural use. The statute details how to determine income and specifies the appropriate capitalization rate.

Counties and cities can enact a special law[25] that requires the assessor to cap assessments on Williamson Act-restricted land at a specified percentage of the property's factored base year value as if unrestricted. Typically, the assessor values Williamson Act property at the lowest of three values: Williamson Act restricted value,[26] current fair market value,[27] or Proposition 13 factored base year

[23] Government Code Section 51200 et. seq
[24] RTC Section 423.
[25] RTC Section 423.3.
[26] RTC Section 423.
[27] RTC Section 110.

value.[28] However, if a local government enacts the special law, the "percentage of factored base year value" option also is available.

Shortly after Proposition 13's enactment, the Legislature added the "percentage of factored base year value" option to address concern that landowners could withdraw from the Williamson Act if Proposition 13 provided more property tax savings. This option guaranteed that if Propositions 13's factored base year value resulted in the lowest value, the local government could choose to allow assessment at an even lower value.

Under this option, the minimum percentage of factored base year value depends on land type: prime agricultural land, prime commercial rangeland, non-prime[29] agricultural land, and waterfowl habitat. Except for "prime commercial rangeland," land type is defined by cross reference to other code sections. The table below lists the specified minimum percentage and cross reference definition for each land type:

Type	Provision	Land Definition	Minimum Percent Reduction
Prime Agricultural Land	§423.3(a)	Government Code §16142(a)(1) Government Code §51201	70%
Prime Commercial Rangeland	§423.3(b)	RTC §423.3(b)	80%
Non-prime Agricultural Land	§423.3(c)	Government Code §16142(a)(2) Government Code §16143	90%
Waterfowl Habitat	§423.3(d)	RTC §423.7	90%

Background: In 1999, legislation[30] changed the cross reference to Government Code Section 16142 for prime agricultural land and non-prime agricultural land definitions. However, RTC Section 423.3 was not updated accordingly. Specifically, former Government Code Section 16142(a) and (b) became Section 16142(a)(1) and (a)(2), respectively. This provision details the per-acre amounts that the state must reimburse to local governments to offset property tax revenue loss related to prime agricultural land and other than prime agricultural land placed into the Williamson Act.[31]

Commentary: This amendment maintains the code.

Administrative Costs: The BOE will incur minor absorbable administrative costs to update publications etc.

Revenue Impact: No impact.

[28] RTC Section 110.1.
[29] Non-prime means "all land other than prime agricultural land, which is devoted to open-space uses of statewide significance, as defined in Government Code Section 16143." Government Code Section 16142(a)(2).
[30] Senate Bill 649 (Stats. 1999, Ch. 1019) amended Government Code Section 16142.
[31] However, subvention payments have been suspended in recent budget years.